REQUEST REPLY BY 7/12

UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D.C. 20555-0001

OFFICE OF THE
GENERAL COUNSEL

June 25, 1999

COMSECY-99-020

MEMORANDUM TO: Chairman Jackson
Commissioner Dicus
Commissioner Diaz
Commissioner McGaffigan
Commissioner Merrifield

RELEASED TO THE PDR
8/11/99 DCW
date Initials

FROM: Karen D. Cyr
General Counsel

SUBJECT: NRC RESPONSE TO REQUEST FOR SUPPORT OF FEDERAL TAX RELIEF FOR WHISTLEBLOWERS

The purpose of this memorandum is to seek Commission approval of a proposed response to a request for written support of legislation which would amend the Internal Revenue Code (IRC) such that it does not serve as a deterrent to whistleblowers.

On April 23, 1999, the NRC received a letter from Mr. Shannon Doyle, requesting that the Commission publicly support legislation which would change the tax treatment of amounts received as a result of employment discrimination claims. On May 13, 1999, the Office of the General Counsel (OGC) sent an interim response to Mr. Doyle, stating that the issue was new to the NRC and under consideration.

Mr. Doyle has informed NRC that, pursuant to a 1989 employment discrimination complaint filed with the Department of Labor under section 211 of the Energy Reorganization Act, as amended, he was awarded amounts for backpay, frontpay and compensatory damages. This award has not yet been paid, as the issue of calculation of the amounts to be awarded is still pending before the Department of Labor. In addition, he was awarded attorneys' fees that are to be paid directly to his law firm by the employer. Mr. Doyle's letter states his concern about the Federal tax treatment of these amounts under current law, which could result in loss of most or all of the award. He argues that this treatment could result in a chilling effect on whistleblowers who would otherwise come forward with health and safety concerns.

Prior to 1996, the IRC excluded from the income tax personal injury damages for both physical and nonphysical harm. The Small Business Job Protection Act of 1996 ("1996 Act") amended

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section 104(a)(2) of the IRC to exclude from gross income only "the amount of damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness." In addition, the 1996 Act added language stating that emotional distress would not be treated as physical injury or sickness. As a result, the exclusion from gross income of awards or settlement money received as a result of an employment discrimination suit is only allowed when the employer's conduct has caused the claimant to suffer physical injuries or sickness. If the claimant receives his or her award as a lump sum, it will be taxed as income for the year in which it was received.

Furthermore, under current law, the claimant must include as gross income amounts received for any attorneys' fees awarded. Apparently, this includes sums paid directly to the attorneys by the employer. A survey of case law revealed that a claimant may deduct legal expenses only as miscellaneous itemized deductions to the extent they exceed two percent of the employee's taxable income.

On October 31, 1997, Representative Gerald Solomon introduced H.R. 2792, which Mr. Doyle referenced in his letter. H.R. 2792 would have amended the IRC in the following ways:

- Amounts received (by suit or agreement) from any claim of prohibited employment discrimination, or for emotional distress or other injury relating to that employment discrimination, would be excluded from gross income.

- Amounts received as backpay based on an employment discrimination claim would be averaged to prevent taxation of a lump sum payment at a higher tax rate than one at which the amounts would have been taxed, had they been received as wages over time.

- Expenses paid or incurred by the taxpayer in connection with an employment discrimination claim would be deductible from gross income as business expenses. This would prevent the taxation of amounts received by the claimant for legal fees.

- Expenses paid or incurred by the claimant in connection with an employment discrimination claim would be deductible in computing alternative minimum taxable income for the purpose of the Alternative Minimum Tax (AMT).

All of these provisions would have been retroactive, applying to expenses paid or amounts received after December 31, 1985. This bill died in committee at the end of the 105th Congress.

On May 27, 1999, Representative Deborah Pryce introduced H.R. 1997, the "Civil Rights Tax Fairness Act of 1999." Its provisions differ slightly from those of H.R. 2792. H.R. 1997 would amend the IRC as follows:

- Amounts received by a claimant (by suit or agreement) from a claim of unlawful discrimination,[1] excluding backpay, frontpay, and punitive damages, would be excluded from gross income. This means legal fees and compensatory damages awarded would not be taxed by the Federal Government.

- Amounts received as backpay or frontpay based on an unlawful employment discrimination claim would be averaged to prevent taxation of a lump sum payment at a higher tax rate than one at which the amounts would have been taxed, had they been received as wages over time.

- Income averaging for backpay and frontpay received from an unlawful employment discrimination claim would not increase AMT liability. This differs from H.R. 2792, in which only expenses paid or incurred by the claimant would not increase AMT liability.

H.R. 1997 is not retroactive. The above provisions would apply to amounts received after December 31, 1998, to a broad variety of unlawful discrimination claimants. The tax issues raised by this bill encompass a broad range of unlawful discrimination statutes, in areas well beyond the purview of the whistleblower protections of section 211.

The NRC has not considered whether the Federal tax laws governing the treatment of awards given to whistleblowers pursuant to section 211 of the Energy Reorganization Act have the effect of discouraging allegers from raising safety concerns, although it is not unreasonable to assume that the potential adverse tax treatment of recoveries intended to make allegers "whole" when they are subject to harassment and intimidation could serve to discourage some allegers from raising safety concerns in the first instance. The Office of the General Counsel consulted with the Department of the Treasury and the Department of Labor, the two agencies with pertinent expertise on the issues raised by Mr. Doyle. Neither agency has taken a position on this type of legislation, which would have a generic impact on employment discrimination claims. While these agencies may ultimately take positions on proposed legislation based on their broader perspectives, the NRC is not prepared to endorse particular proposals due to NRC's more limited expertise and sphere of interest in the area. Nonetheless, the NRC staff supports this legislation in concept, and believes the Federal tax laws should not serve as a disincentive to employees who would otherwise come forward with health and safety concerns. Appended to this paper as Attachment 3 is a proposed response to Mr. Doyle, which reflects the staff position.

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[1]"Unlawful discrimination" is defined in this proposed legislation more broadly than in H.R. 2792; the definition still encompasses section 211. Section 139(b)(17) of the bill defines "unlawful discrimination" as "an act that is unlawful under any of the following: . . . Any provision of Federal law (popularly known as whistleblower protection provisions) prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted under Federal law."

I recommend that the Commission approve the attached response to Mr. Doyle which reflects the staff position and has the EDO's concurrence. If the Commission agrees, OGC would forward copies to the Department of the Treasury, the Department of Labor, and the Office of Management and Budget.

Attachments: (1) Incoming letter
(2) H.R. 1997
(3) Draft response to Shannon Doyle

cc w/attachments: EDO
SECY
OCAA
CFO
CIO

ATTACHMENT 1